

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

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<b>In the Matter of</b>	)	
	)	<b>EB Docket No. 03-199</b>
<b>Section 272(d) Biennial Audit of</b>	)	
<b>SBC Communications, Inc.</b>	)	

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**COMMENTS OF AT&T CORP. ON SBC'S SECOND SECTION 272  
COMPLIANCE BIENNIAL AUDIT REPORT**

**Leonard J. Cali  
Lawrence J. Lafaro  
Stephen C. Garavito  
Aryeh S. Friedman  
AT&T Corp.  
One AT&T Way  
Bedminster, New Jersey 09721  
(908) 532-1831**

**Counsel for AT&T Corp.**

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**COMMENTS OF AT&T CORP. ON SBC'S SECOND SECTION 272  
COMPLIANCE BIENNIAL AUDIT REPORT**

Pursuant to the Commission's Public Notice in the above entitled matter,<sup>1</sup> AT&T Corp. ("AT&T") hereby submits its Comments on the Section 272 Biennial Report for SBC Communications, Inc. ("SBC"), prepared by Ernst & Young, LLP (the "Auditor") and filed on December 17, 2003 ("Auditor's Report" or "SBC's Second Biennial Audit Report") in connection with the second biennial section 272 audit of the SBC companies.

**INTRODUCTION AND SUMMARY**

The role of the section 272(d) audit requirement in "promoting competition in the market for in-region interLATA telecommunications,"<sup>2</sup> assumes even greater importance after the Commission's recent decision in the *Operate Independently Order*.<sup>3</sup> There the Commission

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<sup>1</sup> See Public Notice, *SBC Communications Inc. Section 272 Biennial Audit Report*, EB Docket 03-199, DA 04-149 (January 26, 2004).

<sup>2</sup> Order, *In the Matter of Accounting Safeguards Under the Telecommunications Act of 1996*, ¶ 12, CC Docket 96-150, (rel. Jan. 10, 2002).

<sup>3</sup> Report and Order, *In the Matter of Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, FCC 04-54, 2004 WL 527094 (rel. March 17, 2004).

eliminated the Operation, Installation & Maintenance (OI&M) structural safeguard, relying on the efficacy of the section 272 audit to detect any cross-subsidization that may occur as a result of the sharing of such services, or the failure to make such services available to unaffiliated carriers.<sup>4</sup> In light of this decision, the Commission should complete the process it initiated, but never completed, in 1997 and develop audit standards and procedures that faithfully implement Congress's purposes in mandating such an audit.<sup>5</sup> When the Commission abandoned this process, it allowed the BOCs to effectively control the scope of the audit, and, as is apparent from SBC's Second Biennial Audit Report (as well as the previous audit reports filed by its sister BOCs), the audit inquiries are far too limited and truncated to provide any meaningful review of BOC conduct.

AT&T's Comments on SBC's First Biennial Audit Report<sup>6</sup> identified both the serious flaws in the *General Standard Procedures* used in that audit,<sup>7</sup> and the specific changes that would be required to effectuate the Congress' purpose in requiring section 272(d) audits.<sup>8</sup> AT&T's recommendations were apparently ignored inasmuch as virtually identical *General Standard Procedures* were used in SBC's second biennial audit. The same inadequate

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<sup>4</sup> *Id.* ¶ 21.

<sup>5</sup> See Public Notice, *Proposed Model For Preliminary Biennial Audit Requirements Under Section 272*, AAD No. 97-83, 12 FCC Rcd. 13132 (1997).

<sup>6</sup> Report of Independent Accountants on Applying Agreed-Upon Procedures, prepared by Ernst & Young, LLP and filed on December 17, 2001 ("SBC's First Biennial Audit Report").

<sup>7</sup> Comments of AT&T Corp. on SBC's Section 272 Compliance Biennial Audit Report, CC Docket No. 96-150 (filed Jan. 29, 2003) ("AT&T's Comments on SBC's First Biennial Audit Report") at 21-32.

<sup>8</sup> *Id.* at 33-37.

performance metrics were used.<sup>9</sup> The same limited inquiries were made.<sup>10</sup> The Auditor again failed to go behind SBC's use of "shared services" (non-272) affiliates to avoid posting inter-affiliate agreements on the Internet.<sup>11</sup>

Despite its deep flaws, the Auditor's Report sheds enough light on SBC's practices to confirm pervasive discrimination and other anticompetitive conduct in clear violation of section 272. All of the discrimination identified in the first biennial audit – poorer installation service for DS0 facilities, poorer FOC performance for DSO, DS1 and DS3 service, and poorer repair performance for DS0 and DS1 service – not only continued unabated in the three states audited in the first audit (Texas, Oklahoma and Kansas) but was confirmed to exist in the four additional states audited in the second biennial audit (Arkansas, Missouri, California and Nevada) and with respect to other services in all seven states. The installation metric results were consistently worse for nonaffiliated carriers than for SBC's section 272 affiliate – Southwestern Bell Communications Services, Inc. ("SBCS")<sup>12</sup> – for almost all combinations of states and services. The same was true for the repair metrics in many of the states audited. The pervasiveness and persistence of SBC's ongoing discriminatory conduct demonstrate the sorry consequences of the Commission's failure to penalize SBC after the first audit.

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<sup>9</sup> *Id.* at 18 ("The audit for SBC's 272 affiliates, however, failed to use proper [performance] measurements, which could mask much discrimination") and at 21 ("the measurements used here often provide data in a manner that made it difficult to analyze whether SBC is providing nondiscriminatory access to special access and other key inputs, as required by section 272").

<sup>10</sup> *Id.* at 26 (noting, *e.g.*, the "audit's failure to probe into the financial state and accounting records of SBC's section 272 affiliate").

<sup>11</sup> *Id.* at 30-31.

<sup>12</sup> Ameritech Communications, Inc. ("ACI") was merged into SBCS effective December 24, 2002. SBC's Second Biennial Audit Report, Appendix A at 1.

The Auditor's Report likewise details numerous violations by SBC of its section 272 obligations to, *inter alia*, conduct affiliate transactions on an arms-length basis. Most egregiously, SBC continued to violate the Internet posting requirement, failing to post (or posting only on the eve of the issuance of the Auditor's Report and years after the agreement was executed) critical agreements with its section 272 affiliate. The failure to post these agreements not only precludes unaffiliated carriers from subscribing to those services, but frustrates any effort by unaffiliated carriers to determine if the section 272 affiliate is the beneficiary of below cost arrangements leading to price squeezes against the section 272 affiliate's competitors.<sup>13</sup> Once again, the failure of the Commission to take any remedial action after SBC's first biennial audit is a major contributing factor to SBC's continuation of these violations.

## **ARGUMENT**

### **I. THE AUDIT DEMONSTRATES DISCRIMINATORY CONDUCT BY SBC**

#### **A. The Performance Measures Used In The Audits Show Discrimination In Providing Special Access Services.**

##### **1. Flaws In The Design And Reporting Of The Performance Measurements Preclude Any Finding Of Non-Discrimination**

The same performance metrics were used in both SBC Biennial Audits.<sup>14</sup> Thus, the design flaws identified by AT&T in its Comments on the first audit<sup>15</sup> remain the same. The performance measurements improperly excluded special access services provided by the BOC directly to retail customers, and instead included only access services that the SBC BOCs

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<sup>13</sup> See *Operate Independently Order* ¶ 19 (requiring the posting of any OI&M arrangement between the BOC and the section 272 affiliate so that other carriers could subscribe and to detect and deter below cost pricing).

<sup>14</sup> Compare the *General Standard Procedures* used for SBC's First Biennial Audit Report at 40 with SBC's Second Biennial Report, *General Standard Procedures*, Appendix B at 50. The only difference is the renumbering of performance measurements 4-7.

<sup>15</sup> AT&T's Comments on SBC's First Biennial Audit Report at 21-25.

provided to the SBC affiliates. Furthermore, as AT&T has repeatedly pointed out, requiring the BOCs to collect and the auditors to measure the BOCs' special access performance using performance measures proposed by the Joint Competitive Industry Group ("JCIG") is critical to the uncovering of illegal discrimination.<sup>16</sup>

Once again, the measurements used provide data in a manner that makes it difficult to analyze whether SBC is providing nondiscriminatory access to special access and other key inputs, as required by section 272. As explained more fully in the attached Declaration of statistician Dr. Robert Bell,<sup>17</sup> there are two main problems:

First, the tables for four performance measurements exclude information that must be reported under the *General Standard Procedures*. Bell Decl. ¶ 6. For example, for "Time to Restore and trouble duration" (Performance Measurement 5), the *General Standard Procedures* provide that the Auditor should report "percentage restored within each successive 1 hour interval, until resolution of 95% of incidents."<sup>18</sup> If for a state/month/service combination, it took 8 hours to resolve 95% of incidents, the report should include the percentages resolved within 1 hour, 2 hours, 3 hours, ... through 8 hours. That is what was done for this measure in SBC's First Biennial Audit Report.<sup>19</sup> SBC's Second Biennial Report only shows the percentage

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<sup>16</sup> See, e.g., Letter from JCIG, to The Honorable Michael K. Powell, *Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321 (filed Jan. 22, 2002). The JCIG special access performance measures consist of 11 separate metrics, which encompass ordering, provisioning, and maintenance and repair. The metrics are properly designed, and include appropriate and precise definitions and collect relevant data, including data that is properly disaggregated by type of services involved. See also Comments of AT&T Corp., *Performance Measures and Standards for Interstate Special Access Services*, CC Docket No. 01-321 (filed Jan. 22, 2002).

<sup>17</sup> Attachment 1 hereto.

<sup>18</sup> Appendix B at 51; see also, Objective VIII, Procedure 3, Appendix A at 32.

<sup>19</sup> See SBC's First Biennial Audit Report, Attachment A-7 at 3-6.

resolved within 1 hour, and then the hour at which 95% completion was reached. Omission of this more detailed information potentially masks discriminatory conduct. Bell Decl. ¶¶ 7-8.

Second, the report omits all information that would allow accurate statistical inference (*i.e.*, testing for lack of parity). Bell Decl. ¶¶ 10-12. Sample sizes are not included for any of the five performance measurements for which that information is explicitly required (performance measurements 1, 2, 3, 5, and 7). Bell Decl. ¶ 11. Sample sizes are also needed for the other two measures, but are not included. *Id.* Standard deviations are not included for performance measurement 7, the only measure based on the mean. Bell Decl. ¶ 12. In reporting the data in this manner, the Auditor is clearly seeking to prevent any determination of statistical significance.

## **2. The Performance Data Is Masked Because SBCS Purchases Access Indirectly From The BOC.**

Prior to January 2003<sup>20</sup> SBCS apparently did not purchase access directly from the BOC; SBCS instead purchased access from a “non-BOC, non-272 affiliate.”<sup>21</sup> Thus, both the prior and current Auditor’s Reports contain no data on the provisioning of access services to the section 272 affiliate prior to January 2003,<sup>22</sup> reporting only data for “Non-affiliates” and “BOC & Other Affiliates.” While the data for the provisioning and maintenance of access to SBCS is most likely included in “BOC & Other Affiliates,” the Auditor neither confirms this, nor indicates

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<sup>20</sup> This roughly corresponds with the date on which ACI was merged into SBCS (effective December 24, 2002).

<sup>21</sup> Objective VIII, Procedure 1 (for telephone exchange service and exchange access service) and Procedure 2 (for special access), Appendix A at 30-31.

<sup>22</sup> SBCS was providing long distance service in six in-region states (Texas, Kansas, Oklahoma, Arkansas, Missouri and California) during that period. Moreover, there is a gap in the audit – that is, the prior audit covered the period of July, 2000 to March, 2001 while the current audit covers the period of July 2001 through June 2003. Thus, the period of April 2001 through June 2001 was never audited.



what other data may be included within this category. A third category, “Section 272 affiliate,” is reported for the six month period after January 2003 but it is unclear whether, and to what extent, the prior arrangement continued, and it is unclear what data within “BOC & Other Affiliates” continues to be attributable to the indirect provisioning of access services to SBCS. Clearly, the Auditor should have been required to break out, audit and report the metrics for this indirect provisioning of access services to SBCS.

### **3. Despite These Flaws, The Measures Demonstrate Discriminatory Performance**

Even though the audit measurements were designed and reported in a manner that would preclude any finding that SBC has complied with its nondiscrimination requirements, those limited measurements nevertheless are sufficient to demonstrate that performance was discriminatory.

This is true for the installation measures. The results for Performance Measurement (“PM”) No. 1, “Time from Due Date to Circuit being Placed in Service,” showed consistently worse results (smaller percentage completed by due date) for nonaffiliated carriers than for SBCS for almost all combinations of states and service, DS0, DS1 and DS3. Bell Decl. ¶¶ 15-19 and Tables 1-3. This continues the trend identified in SBC’s First Biennial Audit Report that showed that for the same metric, non-affiliates received worse service *each* of the last seven months in Texas for DS0 facilities.<sup>23</sup>

SBC argues that its “root cause analysis” reveals that the results in the Second Biennial Audit Report “cannot be attributed to the behavior of the SBC BOC alone,” but rather occurred because “non-affiliates requested due dates *less or equal to* the standard due date interval about

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<sup>23</sup> AT&T Comments on the First Biennial Audit at 19.

twice as often as affiliates.”<sup>24</sup> No data to support this explanation is provided in the Auditor’s Report and SBC’s bald assertion is, in fact, contrary to the data submitted by Verizon in its second biennial audit report to support its claim (also made by BellSouth in its Audit Report)<sup>25</sup> that unaffiliated carriers tended to request installation dates that were *longer* than the standard interval.<sup>26</sup> The standard intervals for all three carriers are basically the same – five to eight business days.<sup>27</sup> There is not a scintilla of evidence in any of these proceedings that unaffiliated carriers seek longer, or shorter, installation dates than the section 272 affiliates. The conflicting BOC explanations are transparently contrived to explain away the data collected by the Auditor. Specifically, in the Verizon and BellSouth audits, the data was reported in intervals (in terms of days) and it was clear from the data that it took longer for unaffiliated carriers’ orders to be provisioned. Hence Verizon and BellSouth’s claimed that unaffiliated carriers requested *longer* intervals. For SBC, the data was reported in terms of percentage of orders filled on their due date, and fewer unaffiliated carriers were filled on their due date. Thus, SBC’s claim of *shorter*

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<sup>24</sup> SBC’s Second Biennial Audit Report, Appendix A at 44-45 (emphasis added).

<sup>25</sup> Report of PricewaterhouseCoopers LLP EB Docket No. 03-197 (filed Dec. 23, 2003) Objective VIII, Procedure 4, Appendix A at 45 (BellSouth claimed that the *longer* intervals for installation “only reflect[ed] the business decisions of the customer base.”).

<sup>26</sup> Report of PricewaterhouseCoopers LLP, EB Docket No. 03-200 (filed Dec. 12, 2003), Appendix A:71-A:73.

<sup>27</sup> For SWBT and Pacific Bell the intervals were: for DS0 service, ten business days; for DS1 service, five (SWBT)/seven (Pacific Bell) business days. The tariffs pages in effect during most of the engagement period are appended hereto as Attachments 2 and 3 respectively. It should be noted that the tariffs contemplated negotiated intervals for DS0 and DS1 service of as short as 3 business days. DS3 intervals for SWBT and Pacific Bell during the engagement period were negotiated. Compare AT&T’s Comments on Verizon’s Second Biennial Audit, EB Docket No. 03-200 (filed Feb. 10, 2004) Attachment 2 at 3 (Verizon’s standard interval was nine business days.); BellSouth Guide to Interconnection: Interconnection Services, Issue 12f, December 11, 2003, [http://interconnection.bellsouth.com/guides/leo/html/gctic001/c1\\_2.htm](http://interconnection.bellsouth.com/guides/leo/html/gctic001/c1_2.htm), section 1.2.3.7 (BellSouth’s standard intervals was five to eight days).

unaffiliated carrier orders that could not be filled in time. The explanation in all instances has clearly been shaped to fit the format of the data.<sup>28</sup>

The results for PM No. 2, “Time from BOC Promised Due Date to Circuit being Placed in Service,” similarly show that unaffiliated carriers consistently have lower success rates than SBCS, and are inconsistent with parity service.<sup>29</sup> Bell Decl. ¶ 20. In five states (Arkansas, Kansas, Missouri, Oklahoma, and Texas), including the three previously audited where similar problems were found,<sup>30</sup> non-affiliates regularly received fewer firm order confirmations (“FOCs”)<sup>31</sup> within the first 24 hours than did “BOC & affiliates.”<sup>32</sup> Bell Decl. ¶22.

There is also strong and consistent evidence of discrimination with respect to the repair metrics. For PM No. 5, “Time to Restore, Trouble Duration” unaffiliated carriers received consistently worse performance than SBCS for DS0 service in Arkansas, Kansas, Missouri, and Oklahoma, and for DS1 service in Arkansas and Oklahoma. Bell Decl. ¶ 24. For Arkansas and Kansas, SBC’s First Biennial Audit Report showed similar results.<sup>33</sup> For PM No. 7, “Mean

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<sup>28</sup> Thus, the only purpose of SBC’s representation in the Auditor’s Report that effective July 2003 it will modify its business rules for PM1 “to use the desired due date objective, which considers both the customer desired due date and the standard interval, rather than [sic] the customer desired due date,” Appendix A at 33, can only be to mask its discriminatory conduct.

<sup>29</sup> The data may understate the discrimination against unaffiliated carriers for both of the performance measurements because “[o]rders missed due to customer reasons [were] included in the denominator and counted as ‘made’ in the numerator.” Attachment A-6 at 1 and 3.

<sup>30</sup> AT&T Comments on the First Biennial Audit at 19-20.

<sup>31</sup> Tested by PM No. 3, “Time for Firm Order Confirmation.”

<sup>32</sup> SBC claims that “certain results from PM 3 [FOCs], as noted in the summary of out-of-parity analysis provided by SBC and included in the work papers ... were merely the result of random variations (*i.e.*, the statistically significant differences were random occurrences and not systemic).” *Id.* at 33. This summary is not available in the Report, and appears inconsistent with the data included in the report.

<sup>33</sup> *Id.* at 20.

Time to Clear Network Trouble,” unaffiliated carriers received poorer service than SBCS in Arkansas, Oklahoma and Kansas for both DS0 and DS1 service. Bell Decl. ¶25. Unaffiliated carriers consistently received poorer service than the section 272 affiliate for DS1 service in California and Missouri.<sup>34</sup> *Id.*

It is clear from a review of this data that, as a result of the inaction of the Commission after the first biennial audit, SBC has felt free to continue and to extend its discriminatory conduct to all services and in all the states where it has obtained section 271 authority.

## **B. Other Forms Of Discrimination.**

### **1. Discrimination In The Provision Of Goods And Services**

The SBC BOC appears to have discriminated in favor of BSLD in awarding it the contract for public telephone long distance service over four unaffiliated bids.<sup>35</sup> From a review of the criteria matrix (Attachment A-4) it appears that Unaffiliated Entity 3 had the “most favorable” bid overall. This is conceded for one of the three categories of “Decision Factors” – “Commissions.” However, the BOCs inexplicably rated the other two categories – “Provisioning” and “Miscellaneous” – as “less favorable” for Unaffiliated Entity 3, even though a review of the individual factors that comprised each of those categories suggests that Unaffiliated Entity 3’s bid was overall “more favorable” for the former, and “the same” for the

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<sup>34</sup> A finding of nondiscrimination also cannot be made with respect to the PIC-related metrics. The PIC data reported for PM 4 (“Time from PIC change request to implementation”) is meaningless because excluded therefrom is “PIC requests for lines that are PIC protected”, Attachment A-6 at 7. As shown in AT&T’s prior comments, much of the discrimination arises out of the discriminatory enforcement of PIC freezes. AT&T Comments on the First Biennial Audit at 18, n.4. For PM No. 6 (“Time to restore PIC after Trouble Report”) the audit results showed that non-affiliates were consistently less likely to have PIC restored within one hour after a DS1 trouble incident in Kansas, Oklahoma, or Texas. Bell Decl. ¶ 26.

<sup>35</sup> Objective VII, Procedure 1, Appendix A at 23.

latter. SBC's request that the Commission further dilute the disclosure requirements for such bids<sup>36</sup> would only further mask such discriminatory conduct.

There were also data collection problems with respect to verifying non-discriminatory pricing for services provided by the BOC to both unaffiliated carriers and SBCS. For 11 of the 13 services tested,<sup>37</sup> SBC could not produce a listing of billings for the engagement period. No explanation was provided by SBC as to why it could not produce that data, nor is it evident that a finding of non-discrimination could be made from the "extrapolated data" substituted by the Auditor.<sup>38</sup>

Finally, the Auditor reported that SBC uses a "siloining" requirement to prevent the improper transfer of non-public BOC information to the section 272 affiliate, thus avoiding a violation of "the nondiscrimination obligation imposed on the BOC under Section 272 (c)(1)."<sup>39</sup> But the Auditor did not audit compliance with this requirement under Objective VII as it was required to do.

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<sup>36</sup> SBC's Response at 2-3.

<sup>37</sup> Objective VII, Procedure 3, Appendix A at 24.

<sup>38</sup> The Auditor used billing for the subsequent three month period. *Id.* There were also data verification problems with respect to a twelfth (of these 13) services – local exchange service. As to this last service, the Auditor randomly selected 25 invoices; for 4 of those 25 invoices (16%) "payment support was not provided by SBCS." *Id.* at 25.

<sup>39</sup> Objective VIII, Procedure 1 at 30. Under this procedure, "employees are segregated between services performed on behalf of the SBC BOC and those performed on behalf of the Section 272 affiliate" for "employees below the fourth level of management (senior level decision maker)" so that they "cannot work on both SBC BOC and Section 272 projects." *Id.*

## **2. Potential Violations Of The Imputation Requirement**

The Auditor found that the section 272 affiliate paid \$10.5 million (and expensed \$1.5 million) less than the BOC recorded as revenue for exchange access services.<sup>40</sup> This would be a breach of section 272(e)(3) to the extent that the section 272 affiliate ultimately paid/imputed less for these services than what was charged to unaffiliated carriers. The section 272 affiliate had almost \$3.5 million outstanding 60 days past due accounts receivables due to the SBC BOCs.<sup>41</sup> The Auditor should have, but did not, test the veracity of the explanations proffered by SBC including whether, if the bills and payments were properly aligned over time, the section 272 affiliate fully paid for the services rendered.<sup>42</sup>

## **II. THE AUDIT DEMONSTRATES CROSS-SUBSIDIZATION BY SBC**

### **A. SBC's Failure To Comply With Section 272's Internet Posting Requirements Undermines The Purpose Of These Requirements Which Is To Detect Unlawful Price Squeezes And To Assure Non-Discriminatory Access To Those Offerings.**

In recognition of the BOCs' incentives to engage in price squeezes and other improper cost misallocation, section 272 also includes a variety of provisions that help "prohibit . . . cost-

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<sup>40</sup> Objective X, Procedure 3, Appendix A at 37-38 and Attachment A-12a. The data is less complete for local exchange service, because the Auditor relied on representations by SBC. However, the reported differential for SBCS between the amount it paid and the amount recorded by the BOC was \$81,596.

<sup>41</sup> Objective X, Procedure 3, Appendix A at 39.

<sup>42</sup> SBC explained: (i) that the \$10.5 million difference in payments include SBC payments for amounts billed in prior periods and exclude payments for amounts billed at end of the engagement period; (ii) that the \$1.5 million difference in recorded expenses are estimated accruals (although in Attachment A-12a, the Auditor reported, at n. 2, that the 272 affiliates did not accrue expenses for exchange access service by the BOC) while revenues are actual amounts billed. *Id.* at 37-38. Claims of "time lag" and "[d]isputes" were proffered by SBC to explain the outstanding accounts receivable. *Id.* at 39.

shifting” and aid in detection and prevention of improper cross-subsidization.<sup>43</sup> This includes the requirement that the BOC’s 272 affiliate must “conduct all transactions” with the BOC “on an arm’s length basis with any such transactions reduced to writing and available for public inspection.”<sup>44</sup> Price squeezes are certainly a concern with respect to SBC.<sup>45</sup> Yet SBC has attempted to frustrate any attempt to detect and prove such price squeezes by simply ignoring the requirements of section 272(b) (5).

First, the Auditor’s Report identified three instances where an SBC BOC provided services to a section 272 affiliate without a written agreement:<sup>46</sup> Two involved “customer account record exchange” (“CARE”) services. The first involved a testing arrangement where a BOC affiliate, Ameritech Services, Inc. (ASI), provided BOC services to the section 272 affiliate.<sup>47</sup> The ASI agreement was not posted until 6 to 18 months after services were first provided. The second arrangement involved the direct provisioning of CARE services by the

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<sup>43</sup> First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of Non Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21905 (1996) (“*Non-Accounting Safeguards Order*”) ¶ 9

<sup>44</sup> Section 272(b)(5).

<sup>45</sup> As noted by the Auditor, AT&T has alleged that SBC has engaged in a price squeeze in Texas. Objective V/VI, Procedure 1, Appendix A at 9. *See* Second Amended Complaint of AT&T Communications of Texas, L.P., SOAH Docket No. 473-01-1558, Docket No. 23063 (Texas PUC filed Dec. 5, 2001) (AT&T complaint with the Texas PUC, alleging that SBC’s long distance affiliate began offering intrastate long distance services at rates that are nearly equal to SBC’s intrastate *access charges* and therefore could not possibly allow the SBC affiliate to cover all of its costs). This case is currently on appeal to the Texas Supreme Court.

<sup>46</sup> Objective V/VI, Procedure 4, Appendix A at 14-15.

<sup>47</sup> As AT&T noted in its Comments in the previous audit, SBC has created “shared services affiliates” that take over functions previously performed by the SBC BOCs and then provide those functions to the BOCs and all of their affiliates, including 272 affiliates. AT&T’s Comments on SBC’s First Biennial Audit Report at 30-31. SBC does not disclose the terms of the services provided – thereby avoiding the disclosure requirements under section 272 and the Commission’s rules.

SBC BOC, Nevada Bell, to SBCS. An agreement was not executed until over two years after services were first provided. A third agreement, the only one discovered by SBC's internal Oversight Group that supposedly monitors compliance with section 272,<sup>48</sup> was not filed until over two and a half years after the services were first provisioned.

The Auditor's Report also identified six other agreements that were not posted until years after they were executed.<sup>49</sup> Two involved "Service Agreement[s] for CARE Products" provided by Pacific Bell and SWBT to SBCS. The Pacific Bell Agreement was not posted until almost three years (32 months) after the agreement was executed; the SWBT arrangement over a year and a half (19 months) later. SBCS received two other tariffed services for an undisclosed period of time. These four agreements were not filed until five days before the Auditor's Report was filed with the Commission. A fifth agreement, "Interexchange Customer Online Data Exchange" ("ICODE") was discontinued after almost four years and does not appear to have been ever posted. The last agreement was for On Line Inquiry services and was not posted for almost 9 months after it was executed.<sup>50</sup>

Full and timely posting of the agreements between the BOC and its section 272 affiliate, and then making those agreements available on a non-discriminatory basis to unaffiliated carriers, was the linchpin to the Commission's decision in the *Operate Independently Order* to

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<sup>48</sup> Objective V/VI, Procedure 3, Appendix A at 10-12.

<sup>49</sup> *Id.*, Procedure 5, Appendix A at 17.

<sup>50</sup> It is unclear whether, and to what extent, the "explanations" provided at Appendix A at 43-44 (system freezes, employee transfers and employee errors) apply to these six agreements rather than the 13 late posted agreements identified in Attachment A-3. The BOCs may have also cross-subsidized SBCS by paying an artificially high mark-up for services SBCS provided to them. The Auditor reported that for 9 of the 136 services tested (7%) "the mark-up rates did not agree to the FDC study provided by SBCS. Therefore, no determination could be made as to whether these rates were in compliance with the affiliate transaction rules." Objective V/VI, Procedure 7, Appendix A at 20.



eliminate the OI&M safeguard. The Commission reasoned that the Internet posting requirement combined with the nondiscrimination obligation would make the service available to unaffiliated carriers, and such availability would discourage the BOCs from pricing the service to their affiliates below cost.<sup>51</sup> Yet SBC's brazen and systemic violation of the Internet posting requirement, as now shown by this and the First Biennial Auditor's Report,<sup>52</sup> belies the Commission's reliance on the BOCs' good faith compliance with the Internet posting requirements.<sup>53</sup>

## **B. Potential Violations Of The Structural Safeguards.**

### **1. Joint Ownership Of Switching And Transmission Assets**

Section 272(b)(1) requires the interLATA affiliate to "operate independently from the Bell Operating Company" and the Commission just recently reaffirmed that this includes a ban on joint ownership of switching and transmission equipment.<sup>54</sup> Yet the Auditor could not make such a determination for almost 70% of the assets in the detailed fixed asset listing because there was no disclosure of "from whom the asset was purchased or transferred."<sup>55</sup> Indeed, although

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<sup>51</sup> *Operate Independently Order*, ¶ 19 ("elimination of the OI&M sharing prohibition would allow the section 272 affiliate to purchase OI&M services from the BOC, but the affiliate would purchase those services through a contract negotiated through arm's length dealing, and that contract would have to be reduced to writing and made publicly available. In addition, the BOC would have an obligation under section 272(c)(1) to make those OI&M services, including both systems and personnel, available to unaffiliated rivals on a nondiscriminatory basis").

<sup>52</sup> AT&T Comments on the First Biennial Audit at 32 (5% of the agreements were not posted on the Internet and an additional 3-15% were not posted in a timely manner), citing to SBC's First Biennial Report, Appendix A at 16 and Attachment A-4).

<sup>53</sup> The Auditor also utterly failed to audit the adequacy of the Internet disclosures as required by the *General Standards Procedures*, Objective V/VI, Procedure 5, Appendix B at 37-38. In fact, a review of the website shows disclosures that are incomprehensible and insufficient.

<sup>54</sup> *Operate Independently Order*, ¶ 32.

<sup>55</sup> The failure related to 1,567 of 2,257 assets, representing over 60% of the value (\$73 million/\$118 million) of those assets.

virtually all of the assets without this required disclosure had been placed into service *before* SBC's First Biennial Audit Report, there is a wide discrepancy between the reported number of pre-first audit assets without the required disclosure in the First (456) and the Second (1,561) SBC Biennial Audit Reports.<sup>56</sup> Clearly, the Auditor should have investigated this further.

## **2. Recourse To BOC Assets.**

Section 272(b)(4) provides that an interLATA affiliate “may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company.” In the *Non-Accounting Safeguards Order*, the Commission interpreted this provision to prohibit a BOC, the parent of a BOC, or a non-section 272 affiliate of a BOC from co-signing a contract or other instrument with its section 272 affiliate that would permit a creditor recourse to the BOC's assets in the events of default by the section 272 affiliate.<sup>57</sup> Yet that is, in effect, what occurred here, inasmuch as the section 272 affiliates had revolving lines of credit with SBC Communications Inc. and Ameritech Corp.<sup>58</sup>

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<sup>56</sup> Objective I, Procedure 5, Appendix A at 3.

<sup>57</sup> 11 FCC Rcd at 21995.

<sup>58</sup> Objective IV, Procedure 1, Appendix A at 7.

## CONCLUSION

For the reasons stated, the Commission should (i) finally take enforcement action against SBC for its lack of compliance with section 272; and (ii) should complete the process it initiated, but never completed, in 1997 and develop audit standards and procedures with public input that faithfully implement Congress's purposes in mandating such an audit.

Respectfully submitted,

/s/ Aryeh S. Friedman  
Leonard J. Cali  
Lawrence J. Lafaro  
Stephen C. Garavito  
Aryeh S. Friedman  
AT&T Corp.  
One AT&T Way  
Bedminster, New Jersey 09721  
(908) 532-1831

*Counsel for AT&T Corp.*

March 26, 2004

**CERTIFICATE OF SERVICE**

I hereby certify that on this 26<sup>th</sup> day of March 2004, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: March 26, 2004

/s/ Karen Kotula

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Karen Kotula

## **SERVICE LIST**

Marlene H. Dortch, Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Room CY-B402  
Washington, D.C. 20554\*

Qualex International  
Portals II  
445 12<sup>th</sup> Street, SW, Room CY-B402  
Washington, D.C. 20554\*

Michelle A. Thomas  
SBC Communications  
1401 I Street, N.W., Suite 400  
Washington, D.C. 20005

\* Filed electronically